



House of Commons
Committee of Public Accounts

Department for Transport: The failure of Metronet

**Fourteenth Report of Session
2009–10**

*Report, together with formal minutes, oral and
written evidence*

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The Committee of Public Accounts

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Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

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Summary

In 2003, the Government entered into three innovative 30 year contracts with private sector contractors to upgrade London's underground rail system. Four years later, in 2007, two of the three contractors (Metronet BCV and Metronet SSL, known collectively as Metronet) went into administration when they could no longer meet their spending obligations. While some of the improvements they were contracted to deliver were completed on time and within budget, others have been delayed. The loss to the taxpayer arising from Metronet's poor financial control and inadequate corporate governance is some £170 million to £410 million.

We support well thought through innovation, underpinned by sound risk management. Nor are we adverse to devolved delivery, provided there is robust oversight to protect the taxpayer. But the Department for Transport's (the Department's) oversight and management of risk on the Metronet contracts were inadequate, especially given that it provided a £1 billion a year grant, was ultimately responsible for delivery and carried the majority of the risk of failure. These failings ignored a clear warning from the National Audit Office in 2004 that they should avoid taking a 'hands-off' approach to oversight.

The root causes of the loss to the taxpayer lay in the way the devolved delivery arrangements were set up and in the Department's flawed assumptions about how they would work. The Department's assumption that Metronet would put in place robust financial management and strong corporate governance was naive and, unsurprisingly in the circumstances, did not hold. The Department undermined its assumption that lenders would exercise strong oversight by assuring them that it would meet 95% of the outstanding debt in the event of failure. The Department's assumption that London Underground Limited (London Underground), Transport for London and the Mayor of London would exercise strong oversight also fell when the public sector parties to the contract were unable to obtain the information they needed to oversee the contract effectively.

A serious weakness in the arrangements was that the independent Public Private Partnerships (PPP) Arbiter (the Arbiter) set up by the Greater London Authority Act 1999 to provide insight into the contracts could act only if invited to do so by the parties. He was not invited to act at the earliest opportunity, rendering him largely ineffective. The Department had no formal right of access to the Arbiter and could not direct him to carry out an investigation. The Department has acknowledged that the Arbiter's powers were inadequate and has suggested alternative arrangements, although it will not be drawn on its plans to implement them.

The Department must learn from its mistakes, not just when formulating its plans with the public sector bodies for the long term arrangements to replace the Metronet contract, but also for the other private sector contract with Tube Lines, and longer term, for the Cross Rail scheme. More broadly, the Government needs to play a more proactive role in managing risk when it devolves the management of high value, long term contracts. Departments need, for example, to have the right commercial skills in place and perform robust risk analysis when negotiating such contracts, to monitor the risks thereafter, and be

prepared to intervene where necessary.

On the basis of a Report by the Comptroller and Auditor General,¹ we examined the Department, the Arbiter and the Treasury on their roles in the failure of Metronet.

1 C&AG's Report, *Department for Transport: The failure of Metronet*, HC (2008–09) 512

Conclusions and recommendations

- 1. We find it unacceptable that the Department ignored the recommendation made by the National Audit Office in 2004 to avoid a ‘hands-off’ approach to overseeing the London underground rail system upgrades.** Its failure to be more proactive in managing the risks has cost the taxpayer up to £410 million. We are equally appalled by the cavalier attitude to protecting public money that the Department displayed by claiming that its decision to use the Metronet contracts had been vindicated because there would have been an even greater loss to the taxpayer had the upgrades been overseen directly by London Underground.
- 2. Delivery of major London Underground infrastructure improvements was devolved to others but the responsibility for safeguarding taxpayers’ interests rested firmly with the Department.** As a priority, the Department should review major devolved delivery arrangements at least annually across the remaining life of the project with all of the other key players, and satisfy itself that, between them, they have identified and are mitigating the major risks to value for money for taxpayers.
- 3. It is unacceptable that none of the public sector bodies tasked with oversight of the complicated devolved delivery of the modernisation of London Underground’s infrastructure had the information or influence to do so effectively.** The Department should assure itself that the risks associated with the largest and most complex devolved delivery contracts are being managed. It should require the bodies to whom it has devolved responsibility to exercise strong oversight of contractors and to report their findings to the Department. It should also assess periodically whether the level of review being exercised is adequate and should be prepared to intervene where it has concerns.
- 4. The Department failed to allow and plan for the additional risks to Metronet’s financial viability inherent in having a ‘tied supply chain’, whereby the company’s shareholders were also its suppliers.** The Department should review the way in which it identifies and monitors the risk associated with a tied supply chain on such major contracts. It should set out clearly how it will identify and monitor risks to the financial viability of the prime contractor, and should be prepared to intervene where necessary, even where delivery is devolved.
- 5. The Department was extremely naive to expect lenders to exert strong oversight of Metronet’s governance and financial health to protect their investment when the Department had shouldered all but 5% of the lenders’ risks.** When giving letters of comfort, the Department should identify the impact on its own exposure to risk, and actively seek to reduce or mitigate it, such as by making clear to lenders how it expects them to act. The Department should also monitor the likelihood of its liability maturing. For example, it should reassess the situation when it reviews risks with the contract managers and when it is preparing its financial accounts.

- 6. The PPP Arbiter has no specific statutory duty to protect the public interest or to help the Department monitor the contractor's performance against the contract.** As a priority, the Department should take the opportunity, as part of a permanent solution to the future of the contracts previously held by Metronet, to clarify the role and responsibility of the Arbiter. It should give him powers to help protect public investment by providing assurance on whether work performed is affordable and provides good value for money.
- 7. Action could have been taken much earlier to prevent the Metronet companies going into administration had the Arbiter produced an annual report on Metronet's performance in 2005. However, Metronet and London Underground decided to ask the Arbiter not to produce such a report.** The Department should encourage contract managers to ask the Arbiter to carry out an investigation if suppliers provide inconsistent or inadequate information. In the longer term with respect to Tube Lines, the Department should seek an amendment to the Greater London Authority Act 1999 to allow it to request the Arbiter to carry out investigations where appropriate. The Department should also require, as a minimum, that any new oversight arrangements allow the Department to request investigations, and require an annual review, supported by the audit of financial models, to improve the transparency of information about delays or cost overruns.
- 8. The mistakes made on Metronet should not be repeated on other large scale contracts and Government departments must establish and exercise their right to act where problems of this magnitude occur.** We are pleased to note that on its contract for widening work on the M25, the Department has negotiated rights for the Secretary of State to intervene should the company not be run in the way specified in the contract. The Treasury should monitor compliance with its guidance on sub-contracting and should make clear to departments that similar clauses must be built into all contracts that carry significant risks to the taxpayer.

1 The key players and their roles

1. In March 1998, the Government announced that three new companies owned and operated by the private sector would take over responsibility for maintaining and improving London's underground rail infrastructure under Public Private Partnership (PPP)² contracts with London Underground Limited (London Underground). The three firms—Metronet BCV and Metronet SSL (known collectively as Metronet) and Tube Lines—were awarded 30 year contracts to reverse decades of underinvestment.³ In July 2007, some four years after the PPP contracts were signed in 2003, the two Metronet companies went into administration.⁴ In May 2008, after ten months in administration, Metronet's assets were transferred to two new wholly-owned subsidiaries of Transport for London (TfL). As at October 2009, a joint decision was awaited on the long term way forward from the Mayor for London and the Secretary of State for Transport.⁵

2. The Department acknowledged and regretted the resultant loss to the taxpayer of some £170 million to £410 million.⁶ It considered the PPP contracts to be a particularly complicated investment and upgrade programme with a great deal of uncertainty as to the extent of the work that needed doing. Previous attempts to modernise London's underground rail network had produced substantial cost overruns and the PPP contracts were an attempt to do something different. The Department's view was that this approach had protected the taxpayer better than London Underground overseeing the underground rail network upgrades, and that the loss arising from the Metronet contract was less than cost overruns on previous London Underground work.⁷ It acknowledged, however, that the Metronet PPP contract had not been an unmitigated success.⁸ Some improvements had been made, such as the new Wembley Park station and the refurbishment of District Line trains, but the Department accepted that some of the planned improvements had not been delivered.⁹

3. Under the Greater London Authority Act 1999, strategic and investment decisions for London Underground were devolved to TfL and the Mayor of London (**Figure 1**).¹⁰ The main players involved in the Metronet contracts were the Department for Transport, Greater London Authority, TfL, London Underground, senior debt providers and the consortium behind Metronet (Bombardier, WS Atkins, EDF Energy, Thames Water, and Balfour Beatty).¹¹ The Department saw its objectives as firstly to protect the taxpayer from

2 Complex 30 year contracts awarded to private sector firms who are responsible for the maintenance and renewal of specific London Underground assets. Under the contracts, the firms are responsible for delivering an agreed daily level of service and for upgrading the assets. The firms are subject to financial incentives or penalties, based on their delivery against the performance levels specified in the contracts.

3 C&AG's Report, paras 2 and 3

4 C&AG's Report, para 1.36

5 C&AG's Report, para 3.17

6 Q 140

7 Qq 92, 120 and 121

8 Qq 132 and 134

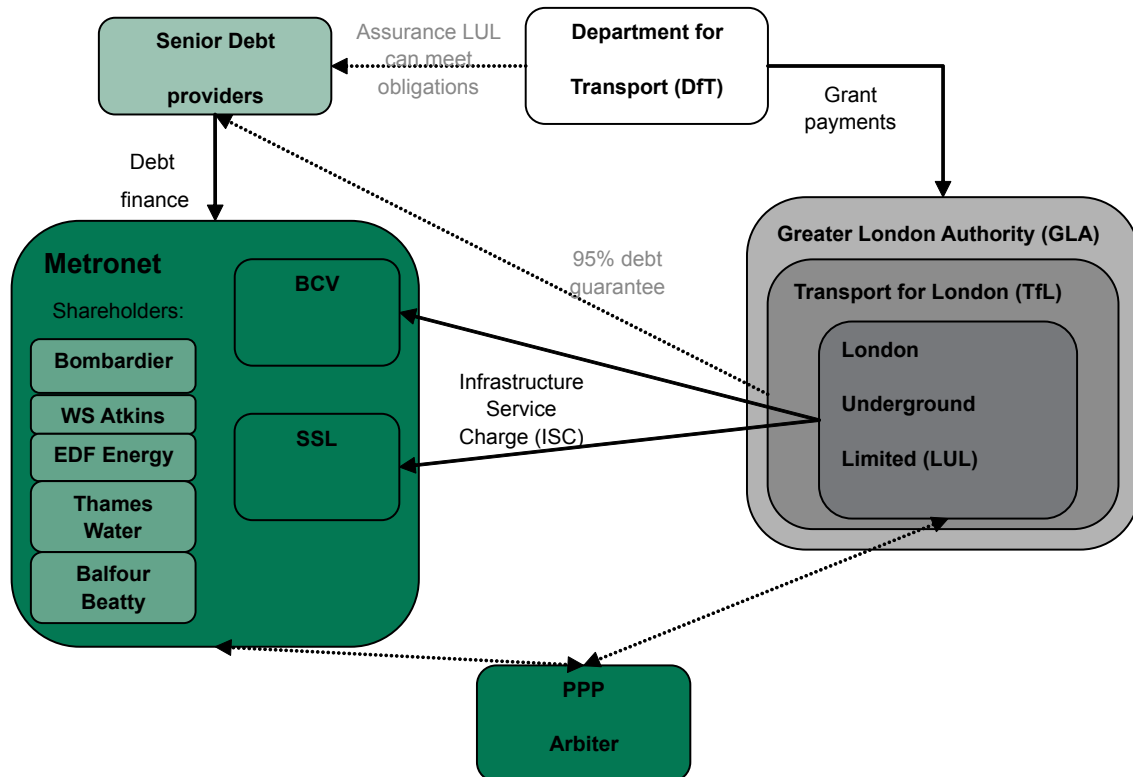
9 Qq 45 and 46

10 Q 55

11 C&AG's Report, Figure 1

potential financial liabilities and, secondly, as ensuring that in delivering the improvements which the taxpayer funded, the PPP contracts were operating effectively.¹²

Figure 1: The key players and their interaction



Source: C&AG's Report, Figure 1

4. The PPP contracts exposed the Department to considerable financial risks, yet left it little scope to mitigate those risks (**Figure 2**). The Department was not a party to the PPP contracts, which were set up between London Underground and Metronet,¹³ and was specifically excluded by legislation from imposing conditions on its grant to the Greater London Authority. This legislative constraint restricted its ability to influence the other players.¹⁴ Instead the Department relied on monitoring the public and private sector bodies that were parties to the contract and seeking their cooperation through its influence as the grant funder.¹⁵

5. The Department paid little heed to the recommendation from the National Audit Office in 2004 that it should avoid a complete 'hands-off' approach to oversight.¹⁶ The Department relied on London Underground, TfL and the PPP Arbitrator to scrutinise performance of the PPP contract, and assumed Metronet's shareholders and lenders would press for robust governance, strong cost control and effective management of the supply

12 Q 39

13 Qq 18 and 21; Committee of Public Accounts, Seventeenth Report of Session 2004–05, *London Underground Public Private Partnerships*, HC 446

14 Qq 2, 41 and 54

15 C&AG's Report, paras 10 and 11

16 Q 2; C&AG's Report, *London Underground: Are the Public Private Partnerships likely to work successfully?*, HC (2003–04) 644, para 10

chain.¹⁷ As the problems with Metronet began to emerge, the Department also relied on informal briefings from the Arbiter.¹⁸ The Department saw its role as to check that all parties played their parts as well as possible.¹⁹ It talked to TfL and London Underground to understand what choices were open to the parties to the contract, who had quite differing views about what they were trying to achieve. The Department told us it had declined a briefing from Metronet’s Chief Executive, on the grounds that the Department was not a party to the contract and was not responsible for taking corrective action.²⁰

Figure 2: Aspects of the PPP contracts exposed the Department to risk without sufficient scope to mitigate it

The Department:	Risk/opportunity
Provided an annual grant of £1 billion as part of a block grant to Transport for London.	Payment of grants to cover infrastructure modernisation costs was potentially an important lever but the Department was unable to maximise devolution by attaching conditions to the block grant to TfL, reducing the direct leverage available to the Department.
Considered that it might have to increase grant levels to meet the cost of extra spending under the PPP contracts where the Arbiter decided that the extra spending had been incurred economically and efficiently.	The Department was potentially liable for additional grant to meet the cost of extra spending where the scope could not be reduced and the cost could not be borne by London Underground or TfL.
Gave an assurance to Metronet’s lenders that if the guarantee was called and London Underground could not meet it, the Department would provide additional funding.	Not a formal guarantee but a comfort letter by the Secretary of State for Transport to Metronet’s lenders.

Source: Qq 2, 41–44 and 54. C&AG’s Report, paras 10 and 11

6. Over the life of the contract, the Department placed a good deal of faith in Metronet and its corporate governance, and in TfL and London Underground’s ability to manage the PPP contracts.²¹ The way the PPP contracts were set up, however, restricted London Underground’s ability to place assurance on a ‘partnering approach’ when it became clear that Metronet was encountering problems. London Underground did not have good enough information and did not have the full array of contractual levers.²² The PPP contracts essentially specified the outcomes to be achieved, giving the private sector contractors space to do things the way they thought best, without the scope for the public sector contract managers to exercise a firm grip.²³

17 Qq 10 and 57

18 Q 50

19 Q 5

20 Q 51

21 Q 85

22 Q 114

23 Qq 130, 165 and 167

2 The importance of understanding and mitigating risk

7. At the heart of the Department's approach to overseeing the PPP contracts was a series of assumptions about the way Metronet, Tube Lines and their lenders would operate. Whilst these assumptions seem to have held so far for Tube Lines, Metronet and its lenders did not operate as the Department expected.²⁴

8. The Department had assumed that the £540 million invested in Metronet by its shareholders would ensure that Metronet would monitor risk closely to protect the shareholders' investment and safeguard their reputations.²⁵ It has now acknowledged that a reliance on private investors' money being at risk was insufficient.²⁶ Each of the five firms invested £30 million equity and £40 million debt in Metronet.²⁷ The Department assumed Metronet would have robust governance structures, and a strong focus on profitability and financial viability. Surprisingly, Metronet did not have the financial management or risk management systems needed to enable its shareholders to make a big return on the PPP contract. When the Arbiter looked at Metronet's financial management, risk management, and asset management in 2006, three years after Metronet entered into the PPP contracts, he concluded that Metronet's systems were poor.²⁸ The company was not well run and did not know what it was doing.²⁹

9. Metronet did not have sufficient knowledge or control over where its sub-contractors were spending the money Metronet received from London Underground.³⁰ For example, in 2007, the cost of refurbishing each of Metronet's stations was twice the amount budgeted.³¹ In contrast, the Department considered Tube Lines had put in place very good programme and project management. Tube Lines reduced the time taken to introduce station modernisation by 40%.³² Tube Lines also had a very strong grip over its contractors and had put all work out to tender.³³

10. The Department assumed Metronet would have a firm grip on its suppliers.³⁴ The Department also underestimated the conflict of interests caused by Metronet's shareholders being its main suppliers.³⁵ While the Department had experience on the A1 upgrade and M25 widening work of successful contracts where a company's suppliers were

24 Q 175

25 Qq 75, 85, 86, 87, 159 and 161

26 Q 177

27 Q 145; C&AG's Report, Appendix 3

28 Q 112

29 Qq 93 and 94

30 Qq 148 and 149

31 Qq 29 and 31

32 Q 32

33 Qq 11, 175 and 176

34 Qq 104 and 105

35 Qq 98, 99 and 101; C&AG's Report, Appendix 4

also its shareholders, the Metronet PPP contract was more complex, covering complete line upgrades including rolling stock and signalling across entire Underground lines and networks. The Department also lacked the levers it had on more conventional contracts to incentivise performance. On the M25 contract, for example, the Department expected it will make payment only when several miles of road have been widened.³⁶

11. Learning from the Metronet contracts, the Department had negotiated on the M25 contract details of how the company would be run and operated, including giving the Secretary of State rights in the event that the company was not run in the way the contractors warranted it would be.³⁷ The Treasury has also revised its guidance to departments on sub-contracting arrangements.³⁸

12. The Department assumed Metronet's lenders would exercise strong oversight of Metronet's governance and financial viability.³⁹ In practice, Metronet's lenders successfully reduced their own risk even before Metronet signed the PPP contracts by obtaining a guarantee that London Underground would meet 95% of Metronet's borrowing in the event of default. Lenders then mitigated the risk further by obtaining a letter of comfort from the Department that it would fund the call on the 95% guarantee if London Underground could not do so. With the London Underground guarantee and the Department's letter of comfort in place before the PPP contract started, it was always the Department and ultimately the taxpayer who stood to make a loss if Metronet failed.⁴⁰

36 Q 77

37 Qq 96 and 97

38 Qq 107 and 108

39 Qq 115 and 116

40 Qq 70–73

3 Making better use of information and independent monitoring

13. The Greater London Authority Act 1999 (the Act) established an independent Arbiter with the twin functions of giving guidance and providing directions. Both functions were exercised at the request of the parties to the PPP contracts (Metronet, Tube Lines and London Underground) when certain disputes arose between them. A critical limitation on the Arbiter's influence was that he could only act or give advice if requested to do so by the parties.⁴¹ There was no duty on the Arbiter to inform the Department and no provision for the Department to ask the Arbiter to undertake a review.⁴² The Department acknowledged that, with hindsight, the PPP contracts could have been worded differently to give the Arbiter the right to make observations without being requested to by the parties.⁴³

14. The Act gave the Arbiter the power to consult, and to carry out either an extraordinary review or a periodic review, if London Underground considered the infrastructure charge excessive.⁴⁴ The decision by Metronet and its lenders, in conjunction with London Underground, to ask the Arbiter not to produce an annual report in 2005 of Metronet's performance adversely affected the Arbiter's ability to produce reliable figures.⁴⁵ It also left the Arbiter without the powers to do anything unless requested to by the parties.⁴⁶ The Arbiter had information powers which, had they been deployed, would have provided valuable insights about Metronet's governance and cost control. If an annual report had been conducted in 2005, the problems at Metronet, and the Department's increasing financial exposure would have been brought out into the open much earlier and action could have been taken which might have prevented the companies going into administration in 2008.⁴⁷

15. With hindsight, the Department regretted that the PPP contracts did not give the Arbiter the power to reduce London Underground's infrastructure charge to Metronet.⁴⁸ The Department had assumed that the large sums of private sector money would be sufficient to motivate Metronet and Tube Lines to run their businesses in a cost effective manner.⁴⁹ Had the Arbiter been empowered to reduce the infrastructure charge, the Department might have been able to avoid the loss to the taxpayer, although reducing the payment would not have guaranteed that Metronet would not have gone bankrupt.⁵⁰

41 Qq 82 and 113

42 Q 81

43 Qq 7 and 8

44 C&AG's Report, para 1.17

45 Q 6

46 Q 156

47 Q 9

48 Qq 162, 163 and 164

49 Q 16

50 Qq 84 and 128

16. The Department acknowledged the need for greater transparency and more prospective analysis of what would be economic and what would be efficient. As part of the long term arrangements for the Metronet contracts, Ministers and the Mayor of London were considering how best to re-structure the arrangements. The Department would not be drawn on whether it intended to change the law to allow the PPP Arbiter to exercise his powers, even if not requested to do so by the parties to the contract.⁵¹

Formal Minutes

Monday 22 February 2010

Members present:

Mr Edward Leigh, in the Chair

Angela Browning
Rt Hon David Curry

Mr Austin Mitchell
Rt Hon Don Touhig

Draft Report (*Department for Transport: The failure of Metronet*), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 16 read and agreed to.

Conclusions and recommendations 1 to 8 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Fourteenth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 24 February at 3.30 pm

Witnesses

Monday 19 October 2009

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Mr Robert Devereux, Permanent Secretary and **Mr Paul Collins**, Head of Regional Transport London and the South East, Department for Transport and **Mr Chris Bolt**, Arbiter for London Underground PPP

Ev 1

List of written evidence

1 Department for Transport

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Oral evidence

Taken before the Committee of Public Accounts on Monday 19 October 2009

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mr Ian Davidson
Nigel Griffiths
Keith Hill

Mr Austin Mitchell
Dr John Pugh
Geraldine Smith
Mr Don Touhig

Mr Amyas Morse, Comptroller and Auditor General and **Mr Richard Wade**, Director, National Audit Office, were in attendance. **Mr Ed Humpherson**, Assistant Auditor General, National Audit Office, gave evidence.

Ms Paula Diggle, Treasury Officer of Accounts, HM Treasury, was in attendance and gave evidence.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL THE FAILURE OF METRONET (HC 512)

Witnesses: **Mr Robert Devereux**, Permanent Secretary and **Mr Paul Collins**, Head of Regional Transport, London and the South East, Department for Transport and **Mr Chris Bolt**, Arbitrator, London Underground Public-Private Partnership, gave evidence.

Q1 Chairman: Good afternoon. Welcome to the Committee of Public Accounts. Today we are considering the Comptroller and Auditor General's Report *The failure of Metronet*. We welcome back Robert Devereux who is the Department's Accounting Officer and Chris Bolt the PPP Arbitrator. Mr Devereux perhaps you would introduce your other colleague.

Mr Devereux: Paul Collins from the London Division in my Department.

Q2 Chairman: This is obviously a very serious matter. The taxpayer was left with a liability of some £1.7 billion. The Report which we have in front of us highlights serious failings in the private sector. The Report also suggests that your Department struggles with effective oversight in cases like this, that maybe you rely too much on other bodies to deliver. What we want to try to do in this hearing is to assure ourselves that you have learned these lessons for the future. This is not the first time we have looked at this. In 2004 the National Audit Office recommended "The Department should avoid a complete hands-off approach for oversight". I would suggest to you Mr Devereux that, rather than taking that advice, you did adopt a hands-off approach. Why did you play such a passive role when problems emerged, leaving London Underground and TfL to sort things out?

Mr Devereux: I want briefly, before I answer that question, just to give the Committee my headline reaction to the C&AG's Report as a way of setting the scene really. Four very brief points. First, I agree with the C&AG that the fundamental problem here was a failure of Metronet in its corporate governance and its shareholders have lost money as a result. Second, I accept that the taxpayer lost money and

since my Department is ultimately responsible for protecting the taxpayer, let me up front accept responsibility for that. Third, the C&AG is only able to make an assessment of the extent of the loss to the taxpayer because the contractual arrangements which were put in place enable us to demonstrate to this Committee that in excess of £4,500 million has been spent economically and efficiently and my Department is responsible for that too. Your Committee will be well aware of the extent of the cost overruns and delays in work previously done before the PPPs. Fourth, as you imply, I have indeed been thinking hard about what lessons are to be learnt and let me see if I can help you adduce them with me this afternoon. Coming back to your question, you give me a charge of a complete hands-off approach and I do not think that is accurate. I also think that, in assessing whether or not that is correct, we have to keep in front of us the nature of these contracts and arrangements which were put in place. As I think you quizzed my predecessor in the 2004 hearing strongly enough, these contracts were being put in place right at the point at which we were giving effect to the Greater London Act and creating a new Mayor, a Mayor whom Parliament willed to be strong and that did not allow the Department to have conditions set on the grant it gave to the Mayor in order to maximise the devolution. In that context and mindful of the cost overruns which have been seen previously on work by London Underground and in particular on the Central Line and the Jubilee Line, the Department decided to embark on the PPP contract which, without a shadow of a doubt left clear roles for Metronet the company and its lenders as well as LUL. They were the parties to the contract and we can go round as many times as you like this afternoon the extent of the Department's role in that

but the role that we had was essentially one of influence behind the scenes and not one of direct action.

Q3 Chairman: I am aware of that. We understand from reading the Report, paragraphs 1.28 and 1.29. We know about the contractual terms. But despite these contractual terms, when so much taxpayers' money is at stake, could you not have found a way to have played a more energetic role?

Mr Devereux: I guess I should like first to make sure we all have the same view about what role we were playing because pretty much consistently you have portrayed—

Q4 Chairman: A role which might have saved us £1.7 billion, as has emerged.

Mr Devereux: The estimate of the loss in this case is not £1.7 billion.

Q5 Chairman: The liability if you like; the liability of £1.7 billion.

Mr Devereux: The liability of £1.7 billion has been met and that is a liability which the taxpayer would have met in any case over 30 years and it is, as I think one of my previous secretaries of state tried to describe it, akin to repaying the mortgage early. The loss with which we are concerned today is a much smaller number, namely £170 million to £410 million which the C&AG assesses and when you have asked twice now why I did not play a more energetic role, let us just think what role was open to us. We were certainly doing the following things. While I was in the Department, we were keeping in touch with the Arbiter, to make sure we knew what the developing position was, initially on a regular basis, more frequently as it went through 2005–06. Paul Collins and his colleagues were likewise engaged with TfL, both with London Underground itself and with TfL's corporate finance. We were seeking to ensure that we understood what the choices were which were open to the parties, and to ensure that they played their part as well as possible. As you will have seen from the evidence already given to the Transport Select Committee, these parties actually had quite differing views about what they were trying to achieve at some of these steps and as parties to the contract we were trying to make sure, as far as we could, that they did the right thing.

Q6 Chairman: You mentioned the Arbiter, so let us go straight to him then. If you look at paragraph 2.15, "The Arbiter's ability to produce reliable figures was, however, adversely affected by the decision to waive his 2005 Annual Report of Metronet's performance". Are you confident that you used the knowledge and insight of the independent Arbiter satisfactorily and to a sufficient extent to the maximum possible effect?

Mr Devereux: With the benefit of hindsight, I think the Arbiter should have been given stronger powers than he had to use. It was neither my call, nor his, to waive that 2005 annual review. That was a matter for Metronet and its lenders, in conjunction with London Underground.

Q7 Chairman: So you could have used it more, you accept that.

Mr Devereux: I have said that, and the Arbiter had said it in previous hearings as well.

Q8 Chairman: Mr Bolt, what do you think? Were you used enough?

Mr Bolt: As the Committee will be aware, the functions I have under the Greater London Authority Act are exercised at the request of the parties. Clearly, with hindsight, that Act could have been worded in a different way to allow me to take action without the request of the parties.

Q9 Chairman: So you were not used enough.

Mr Bolt: I stand by the view I have expressed previously to another committee that had that 2005 Annual Report been conducted the problems at Metronet would have been brought out into the open much earlier and action could have been taken which might have avoided the final administration of the companies.

Mr Devereux: If you are interested in lessons, let us observe this then, that the Arbiter had information powers which both he and I are saying, had they been deployed, would have told us something valuable. The contract was not set up in such a way as to give him the right to make those observations straight off and with the benefit of hindsight we should have set the contract up in such a way that the Arbiter was required to inform the parties. This is a theme I am going to come back to several times because actually it is critical to how you would set this up in a different way.

Q10 Chairman: It says here in paragraph 12 on page 6 "DfT was obliged to rely on other parties". Did you at least assure yourself that they were carrying out their role satisfactorily?

Mr Devereux: Yes, I sought to. The other parties in question were three fold: two of them, Metronet shareholders and the lenders, had been established with very substantial sums of their own money at risk. We will argue later about the extent to which the debt was guaranteed but at least, at first approximation, some hundreds of millions of pounds both for shareholders and lenders were at risk. On that basis, the Department did indeed assume that those entities would have a vested interest in making sure that, were Metronet to start going wrong, they would actually put it right because they would not have an interest in losing that cash. Again with the benefit of hindsight, that incentive arrangement there, £350 million of equity, £190 million of uncovered debt and £540 million in total, was, in my view amazingly, not adequate to bring people to the party.

Q11 Chairman: Let us look at paragraph 13. "When the extent of Metronet's problems emerged in early 2006, DfT's response reflected the limited number of levers it had to influence the progress and the outcome of the PPP contracts". Did you assure yourself that Metronet had enough independence from its suppliers?

Mr Devereux: When the contracts were being procured and bids were being assessed, it is my understanding that the Department looked to make sure that they had a financially viable and financially robust structure. The decision at the time was that that structure was indeed robust. As you are probably well aware, tied supply chains do work in other circumstances; there is nothing fundamentally misconceived about them. However, in this case, the judgment which went with a tied supply chain and all that £540 million at risk clearly has not been sufficient to get people to focus on mistakes and errors when they started to occur.

Q12 Chairman: These deals cost the taxpayers millions: £130 million in advisory fees for a deal which was supposed to last 30 years but in fact only lasted for four and a half years. Then a lot of money paid to banks to cancel loans. This is a lot to pay for inefficient investment in the Tube is it not?

Mr Devereux: It is a lot.

Q13 Chairman: Advisory fees of £130 million, for instance and you keep telling me that with the benefit of hindsight and all the rest of it. If you are spending this amount of money, maybe we should not have to rely on hindsight.

Mr Devereux: Let me just try to explain what the counterfactual is. Your Committee would have looked at what London Underground had delivered previously before the PPPs when the Central and Jubilee Lines overran by 30% and six years. Against that background it is incumbent upon the Department to do better than that. I have already acknowledged that there is a loss in this case. It is my contention that it is considerably smaller than the loss which occurred in previous cases.

Q14 Chairman: Who are we going to rely on in future to protect the taxpayer?

Mr Devereux: You are going to rely on me because I am the Accounting Officer.

Q15 Chairman: You have not done very well up to now, have you?

Mr Devereux: With the greatest of respect, you are asking me to comment on a situation that I have inherited.

Q16 Chairman: I am afraid you cannot plead the fact that you were not there. Your Department has not done very well up to now. Tell me now what you are going to do in the future to protect the taxpayer.

Mr Devereux: Shall I go through my lessons now? Let us go through them in order. The only reason that the C&AG can compute that there is a loss to the taxpayer, fundamentally, is because more taxpayers' cash went into this company than was commensurate with the economic spending of that company. I come back to the point you made about the Arbiter. Had we established the Arbiter on the basis that as soon as the potential uneconomic cost of this company was getting close to, but below, the equity and debt buffers, it would have been possible for us to construct this contract in such a way for the

Arbiter to raise his flag and say "I have today concluded that the potential uneconomic cost is getting close to the debt and equity buffers, therefore I give London Underground the right to pay less, notwithstanding what the contractual arrangements are about the infrastructure service charge". Had that particular ability to dial the tap down been put in place by my predecessors, then we would have been able to avoid the loss that we are talking about. I am not guaranteeing that the company would not have gone bankrupt. I would have guaranteed though that we would not have put the cash in. That is a really important distinction. We have essentially assumed that half a billion quid was enough to focus anybody's mind on correcting any errors which turned up in the company. That turned out to be false, and what I have just described is the mechanism which, had it been in place, would have protected me even from such a shipwreck.

Q17 Mr Touhig: Mr Devereux, your Department was responsible for drafting the PPP contracts was it not?

Mr Devereux: My Department had responsibility for—

Q18 Mr Touhig: Drafting the contracts.

Mr Devereux: No, not for drafting the contracts.

Q19 Mr Touhig: Somebody else decided what went in them then.

Mr Devereux: The responsibility for drafting the contracts lay with London Regional Transport which reported to the Secretary of State at the time.

Q20 Mr Touhig: So it came to your Department at the time.

Mr Devereux: We were responsible for the contract.

Q21 Mr Touhig: Who was responsible for deciding the successful contractors?

Mr Devereux: London Regional Transport.

Q22 Mr Touhig: Did it have to come to your Department?

Mr Devereux: I think the answer is yes.

Mr Collins: Yes.

Q23 Mr Touhig: So the interpretation of a latter-day Pontius Pilate which you have just given the Chairman, "Nothing to do with me gov", the buck stops with you, does it not?

Mr Devereux: No, I am not going to accept that, I am afraid, because I started this by acknowledging that there was a loss, and I was taking responsibility for it.

Q24 Mr Touhig: It is easy to acknowledge a loss; we as the taxpayers are picking up the bill. Your Department has a responsibility—I personally accept that you were not there at the time; I understand all that but your Department was responsible—for this whole process and the buck must stop with you surely.

Mr Devereux: It does.

Q25 Mr Touhig: We have established that. We know from paragraph 1.34 on page 17 that there was a shortfall of £1.8 billion in Metronet's bid. Why was that not noticed at the start? I assume you looked at the bids even though you were not responsible for giving the contracts out at the end of the day.

Mr Devereux: I think you will find that figure refers to what was actually bid and subsequently what emerged.

Q26 Mr Touhig: There was a shortfall of £1.8 billion and did that not ring any alarm bells?

Mr Devereux: It was not known at the time the contracts were let.

Q27 Mr Touhig: It was not known?

Mr Devereux: No because the bid was £1.8 billion less than that. Figure 5 demonstrates what the company expected to spend, that is the column called Source on the right-hand side, and the column called Spend is what they subsequently realised they would need to spend.

Q28 Mr Touhig: So none of this was known by your Department. That is what I am trying to establish.

Mr Devereux: At the time the contracts were let, by the time the contracts were let.

Q29 Mr Touhig: In paragraph 1.22 on page 15 of the C&AG's Report it tells us that in 2007 the average cost of refurbishing each station was twice what they had budgeted for. Did that not sound any alarm bells, any warning lights?

Mr Devereux: That sounded alarm bells, yes, because we were now into the period of the contract and these were facts that were coming to light as the contract progressed.

Q30 Mr Touhig: So what happened then?

Mr Devereux: What happened then is what is recorded in the C&AG's Report.

Q31 Mr Touhig: Did you not intervene then and say something is going wrong here? The average was twice the budgeted figures; some were three times higher than the original figures. All these red warning lights and your Department does not notice them?

Mr Devereux: The Department does notice them. I have explained what the Department's position is in these contracts. Let me also explain the fact that a particular cost is increased in one area does not of itself lead inexorably to there being a loss for the taxpayer. Tube Lines has, for example, already incurred substantial additional costs on its stations and that does not necessarily mean there is a loss which the C&AG is going to assess as uneconomic and inefficient.

Q32 Mr Touhig: Surely any housewife will tell you that if she has less money coming in and she cannot manage her household budget, there is a problem.

This is much more complex than that of course but here are warning lights and your Department does not take any action.

Mr Devereux: Any housewife would indeed say that. The Transport Select Committee, having looked at what Tube Lines has done congratulated them, for example, on their ability to reduce the time to refurbish escalators from nine months to nine weeks. They congratulated them on reducing the time to introduce station modernisation by 40% and they congratulated them on things they were doing in this contract. These people bid for a contract, they then sought to bring their expertise to it and in the process they learn about how to do things and how to make savings. It is a characterisation of this story which you can even find here in Metronet; even while some things were costing more there were other areas where they were indeed making savings below what they thought they would.

Q33 Mr Touhig: There has been a huge loss to the taxpayer.

Mr Devereux: Yes.

Q34 Mr Touhig: Your Department had overall responsibility for this.

Mr Devereux: Yes.

Q35 Mr Touhig: You do not seem to want to accept that responsibility.

Mr Devereux: I am sorry; I do not see how you understand I do not want to accept it.

Q36 Mr Touhig: Has anybody been sacked as a result of this? Has anybody been dismissed in the Department? Surely somebody has to have responsibility for this? Yes or no? It is a simple question. Has anybody been sacked as a result of this debacle?

Mr Devereux: I am not going to go there.

Q37 Mr Touhig: You do not know.

Mr Devereux: I am not going to go into what has or has not happened.

Mr Touhig: Chairman, are we entitled to ask these questions?

Q38 Chairman: We can ask. If you do not know the answer you can send us a note.

Mr Devereux: I will send you a note.

Q39 Mr Touhig: That would be helpful. The C&AG's Report tells us that though the Department itself was not a party to the contract, as you have made clear, it had the job of securing two particular objectives. First of all protecting the taxpayer from potential financial liabilities and, secondly, you were responsible for ensuring that in delivering the improvements which the taxpayer funded they were operating effectively. You failed on both counts.

Mr Devereux: If the C&AG concludes that there is a loss to the taxpayer the answer to that question must be yes.

Q40 Mr Touhig: Good; on both counts.

Mr Devereux: If you are interested in the lessons learned, we will go on to those.

Q41 Mr Touhig: On page 6, paragraph 10 we see that you told those who loaned money to Metronet that you would step in if there were a problem. Why did you do that?

Mr Devereux: We did two different things. First of all, the deals were structured on the basis that London Underground itself guaranteed 95% of the debt and associated costs in the event of a default. Since the lenders were looking at London Underground and seeing a body largely financed by the Department itself, they looked to us for some comfort that, were LUL unable to meet that guarantee, we would not leave them in a position where they could not meet it. We issued a comfort letter to the effect that we would meet that. To answer the question why we did it and why the number was 95%, you will be aware from conversations with my predecessor and some of the evidence from the Transport Select Committee that, at the time these deals were being brought to conclusion, there was a fairly substantial disagreement going on between the Government and then Mayor as to his likely attitude to these contracts which in our judgment affected the level of guarantee which was ultimately given.

Q42 Mr Touhig: So although you did not guarantee Metronet's borrowing, you were under pressure to protect the investors.

Mr Devereux: No, the point I am making is a slightly technical one. London Underground guaranteed the borrowing. We gave a comfort letter to the lenders to say that in the event that guarantee was called, we would not stand by if they found themselves unable to meet it.

Q43 Mr Touhig: I wish you were my bank. Can we go on then? We see on page 22, paragraph 2.23 that when Metronet went into administration in 2007, you made £1.7 billion available to pay its lenders. Can we get back to the point I was just asking about? That meant that you picked up the tab for the 95% guarantee that Transport for London offered.

Mr Devereux: I paid £1,700 million for a settlement of an obligation which the NAO records.

Q44 Mr Touhig: So you picked up the bill. They gave a guarantee and you picked up the bill.

Mr Devereux: TfL paid £1,747 million and I paid £1,700 million, so I substantially picked it up.

Q45 Mr Touhig: So the taxpayer substantially picked it up because of your Department. Can you understand that there must be a lot of anger at this awful waste of public money? Would it not have been simpler to have given these people the keys to the Royal Mint at Llantrisant and they could have gone in and printed their own money? It is an appalling effort on your partner's part, is it not?

Mr Devereux: I am afraid I am going to come back to the same line I took with the Chairman. We are talking about a particularly complicated investment and upgrade programme in tunnels where there is a great deal of uncertainty as to what is in there. Previous attempts to do this have produced very, very substantial cost overruns. We have tried something different this time in the context of a devolved settlement and the extent of the uneconomic cost which has now been estimated—and you have never had one before in this Committee—is actually lower than the overall cost overruns previously. What am I pleading? I am pleading that we are protecting the taxpayer better than our predecessors but clearly not perfectly.

Q46 Dr Pugh: There were cost overruns in the past, I understand the point you are making, but nevertheless we do not have the improvements we were expecting to get and, as the Chairman said, four years for the whole project instead of 30 years.

Mr Devereux: I am sorry. You said you do not have the improvements you expected. Some things clearly have not been delivered to the time expected, some things have. We do have District Line trains refurbished, we do have a Jubilee line, we do have Wembley Park; the list is growing all the time.

Q47 Mr Touhig: So it is growing all the time.

Mr Devereux: To say that you do not have any benefit is wrong.

Q48 Mr Touhig: I did not say we do not have any improvements. We have not had what we expected to have.

Mr Devereux: You have not had what you were expecting but the C&AG is telling you that £4,500 million has been economically and efficiently spent. I would have thought the Committee would welcome that.

Q49 Mr Touhig: I am sure we do but we do not welcome the fact that your Department oversaw and were responsible for a massive draw on the taxpayer, wasting public money. I think you ought to be ashamed of yourselves.

Mr Devereux: I explained already that the massive draw you keep coming back to, the £1.8 billion, is not of itself an estimate of loss, nor does the C&AG accept that.

Q50 Keith Hill: I probably ought to begin by making a declaration of interest, not for the first time. I was the Minister for Transport in London between 1999 and 2001 and the chief public advocate of the London Underground PPP; very enthusiastic. My excuse is of course that I had moved on to other things by the time the contracts were signed. Naturally I am disappointed with the way the Metronet contracts developed. I recognise that the DfT was not a party to the contracts but the Department were paying £1 billion a year to TfL specifically for the PPP contract and in the end, as we know, had to provide £1.7 billion of public money when Metronet went bust, of which up to £410

million was not spent economically or efficiently. Therefore I do sense that in these circumstances the Department did adopt a rather arm's-length relationship with the project. It liaised with London Underground and TfL. As the problems of Metronet developed, you received informal briefings from the Arbiter but you did, for example, refuse to meet directly with Metronet.

Mr Devereux: Indeed.

Q51 Keith Hill: We have to think really about this management for the future and I want to turn to the recommendations which the NAO make in recommendation B on page 9 and ask really how the Department propose to respond to these proposals. First of all, it is recommended that the Department should "collect and analyse a range of financial and performance data held by parties to the contract or available independently". Is that work underway?

Mr Devereux: Let me start by coming back to your observation about the letter my predecessor wrote on 17 May because I have it in front of me. Let us just think what the alternative is. Here I have two parties who have signed a contract with respective obligations in, and it becomes apparent to all parties that Metronet the company is not delivering what it should do. In those circumstances I understand perfectly why my predecessor chose not to accept a briefing from the Metronet chief executive who, I suspect, was at that stage seeking somehow to make his case to a party who was not responsible for fixing it. If you think about what sort of messages would be sent, you risk the public sector giving mixed messages about what is going on here. It seemed to him far better that the contractual counterparty, in this case London Underground—and we did know what they were doing—should get on and have those conversations, not the Department to give its own views and opinions to Metronet, but rather say "Look, this is your problem, you need to fix it"—

Q52 Keith Hill: Sorry to cut across you but my time is limited. That is a bit of historical speculation in a way.

Mr Devereux: But it is the reality.

Q53 Keith Hill: Going forward, there does seem to be a strong argument that DfT should perhaps be a little more on top of what is actually happening—I was going to say on the ground—in this case under the ground. Just let me ask. Are you collecting data about performance in a way that maybe historically you did not? That is a yes or no one really.

Mr Devereux: The answer is that I already have performance data, which I was telling you that I was looking at, both in respect of what LU was up to and also what the Arbiter was telling me. I do have information such as that.

Q54 Keith Hill: Okay. In that case I will take it that the answer to the first proposal under recommendation B is yes. What about the second item in the recommendation which is to "request regular risk reports from London Underground and TfL as the contracted clients"?

Mr Devereux: The reason I am just pausing on this is because I do want to come back to the nature of the devolution settlement with the Mayor. I do not know whether you've had a long conversation with the Mayor about his view as to where the buck stops with him and where it goes to the Department. But when it comes to these contracts, I am indeed paying £1 billion for the Tube through a grant, a grant which Parliament has specifically restricted me from setting any conditions on, conditions along the lines of "By the way, here's £1 billion, I'd like to see the following information every Monday in my office; I'd like to see all these risk reports".

Q55 Keith Hill: But it is possible for departments to have a close and successful and efficient working relationship with third parties which have devolved expenditure. We have had before us quite recently the Department for Children, Schools and Families to talk about the *Building Schools for the Future* programme which, after a bit of a faltering start, is proceeding very, very efficiently, delivered by local government primarily but on the basis of a very close working relationship between national government and local government. Here you have national government and a regional authority. Surely it ought to be possible for you to have and expect regular risk assessments from London Underground about the progress on both the contracts on which we are expending £1 billion a year.

Mr Devereux: I am agreeing that it ought to be reasonable to ask for that. In practice, the nature of the relationship we have with TfL is that we see a lot of this. I am trying to draw a line between what actually happens in practice as a piece of influence and what I can require as a piece of policy and legislation. Were the Mayor to determine that he did not want to show me this, he would be entirely within his rights as Parliament has granted to him.

Q56 Keith Hill: I understand that but I am sure this Mayor, just like the last Mayor, would be only too willing to work on a reasonable basis with the Department on this, if requested to.

Mr Devereux: I agree and when we come onto the future that is the place we are going to be.

Q57 Keith Hill: I am on the future now. Let me just ask you finally about the third part of recommendation B, and this is what we have been talking about, "review the devolved body's understanding of the key risks of the project". This is really very important, is it not? At the end of the day you really, as a department, relied on London Underground and TfL to assess whether the project was being delivered in a cost-effective way.

Mr Devereux: Yes.

Q58 Keith Hill: And actually it is perfectly arguable that they did not, particularly in the case of Metronet, monitor and scrutinise the performance of that body in as much detail as possible. Therefore it is very important for you to be assured that they are going to do that job properly in the future. Do you have that assurance?

Mr Devereux: The position on where we are going to be in the future is covered by recommendation F later on, is working with the Mayor and TfL on what the successful arrangements for Metronet are. I am expecting my Secretary of State and the Mayor to make announcements about this very shortly. I think that will give you some comfort that we are in the space of reasonable men.

Q59 Keith Hill: That is very interesting. We look forward very much indeed to that. It seems to me that you have been really rather positive about the future role of the Arbiter. I think I quote you correctly when you said in retrospect that the Arbiter should have been given greater powers. Actually, if you look at recommendation E on page 10 three powers are set out there which the NAO recommends that the Arbiter should exercise in future, namely to carry out recommendations, where appropriate, to require an annual review of the Arbiter and to allow an extraordinary review even if not requested by the parties to the contract. Is it your intention as a Department to strengthen the Arbiter in this way?

Mr Devereux: Strictly speaking one, two and three are not all addressed to the Arbiter but the general point is this. If we are to exist in a world in which LU on the one hand and a contractor on the other is delivering work with very large sums of money at stake, I want to see a degree of transparency about what is going on there and a degree of prospective looking at what is economic and what is inefficient.

Q60 Keith Hill: Is the Arbiter going to play a bigger role than heretofore in achieving that?

Mr Devereux: The Arbiter's actual role is defined by statute in respect of the PPP.

Q61 Keith Hill: But you can always change the law.

Mr Devereux: I can change the law, parliamentary time permitting.

Q62 Keith Hill: Are you envisaging that?

Mr Devereux: What ministers and the Mayor are trying to sort out at the moment is the best way in which the substance of this can be given effect to.

Q63 Keith Hill: Mr Bolt, let me finally ask you as the Arbiter, would you welcome these additional powers?

Mr Bolt: I would welcome them, to build on what I am doing already but with one hand tied behind my back.

Q64 Mr Mitchell: I began to think I should change places with Keith Hill after that astounding opening statement. Really you must feel like the fall guys. You did not devise this insane structure, you did not devise the financing arrangements, it was forced on you by Treasury, was it not?

Mr Devereux: It is kind of you to say that I did not devise it. I have already been slapped for seeming to imply, which I did not, that I was not responsible.

Let me be clear, I do not think that the PPP structure per se is the thing which is at fault so you are not going to tempt me into—

Q65 Mr Mitchell: Why not? There was a long argument between the Chancellor and Ken Livingstone as to how this contract should be managed, who should run it and how it should be financed.

Mr Devereux: Correct.

Q66 Mr Mitchell: Ken Livingstone lost and you face the consequences.

Mr Devereux: Yes.

Q67 Mr Mitchell: Do you agree?

Mr Devereux: What I am agreeing with is this . . .

Q68 Mr Mitchell: You carried the can.

Mr Devereux: No, no. You are asking me whether I am going to dissent from the creation of the PPP in the first place. I am making an observation.

Q69 Mr Mitchell: That was not your job but you carried the can effectively for the failure of the arrangements made by Treasury and the Chancellor.

Mr Devereux: The Department went into this. My predecessor as accounting officer signed off that this was a good value for money deal so I am not going to take that we were taking dictation.

Q70 Mr Mitchell: Okay, if you want to bring others down with you it is not my business. Surely in that situation it is insane to give a guarantee that you would step in if the Private Public Partnership failed? Why did you do that?

Mr Devereux: I think the short answer to that is that in order for this deal to be done and completed it turned out to be necessary to have a degree of guarantee.

Q71 Mr Mitchell: Were you under instructions from Treasury to do that?

Mr Devereux: No, it was clear that the market appetite for this was such that it was not going to happen with a 0% guarantee.

Q72 Mr Mitchell: Would the deal have gone ahead without that?

Mr Devereux: I think not. I am not sure what the counterfactual is. The only thing we have is that the deal was done on the basis of a 95% guarantee. Let us be clear about some of the things which were being tackled here. This is not a simple bit of road widening or something we had done hundreds of times before. We are talking about an outcome contract which gives maximum flexibility to the private sector.

Q73 Mr Mitchell: Yes, but we have been told for years that the advantage of these contracts is that we can get the efficiency of capitalism and private enterprise and they will bear the risk. In fact you took the risk on from the start.

Mr Devereux: I had clearly taken on a very large proportion of the risk and we can argue about whether that was the right proportion to take. I did not take on 100% of it.

Q74 Mr Mitchell: You did not object to taking on the risk, you just argued about the proportion.

Mr Devereux: No. I think you are misrepresenting the proposition here. The proposition here is that you could have left this to be done by London Underground in traditional fashion. Right? There would have been no outcome specification.

Q75 Mr Mitchell: That was decided against. We now bring in business and we are bringing in big companies which are supposed to take the risk and you rushed to take it from their shoulders.

Mr Devereux: No, I did not rush to take it from their shoulders and at the end of the day £500 million of private money was at risk in this deal and has gone. You may wish it had been £1 billion, £1.5 billion or £2 billion but the market at the time did not bear that sort of calculation, largely because the extent of the work that was necessary was not entirely clear.

Q76 Mr Mitchell: Actually it was because a lot of greedy people wanted to make money out of being suppliers and do the contract in the first place and the Government did not have the business nous, Transport for London did not have the business nous, London Underground did not have the business nous and you certainly did not, to control this monster.

Mr Devereux: I am not sure I accept that. You can make that as an assertion.

Q77 Mr Mitchell: Another assertion. Can a structure in which you cannot directly control the performance of the businesses, you are supervising somebody else who is supervising somebody else, with a very unsatisfactory corporate governance arrangement, it would seem in retrospect certainly, can that structure possibly work?

Mr Devereux: You very kindly helped me out here by just observing the points you are making are with the benefit of hindsight. At the moment I am sitting here with a reality of where Metronet is. It is clear, as I have already said, that tied supply chains of themselves do not necessarily mean that things will fail. I have a tied supply chain which delivered me the A1 upgrade for example. I have a tied supply chain on the M25. The nature of that contract, because it is work which I understand how to do, is such that nobody is going to be paid anything for widening the M25 until several miles have been widened. We will pay for it as and when we see some widening. That is not the nature of this contract because of the complexity of completing complete line upgrades, including rolling stock and signalling across an entire line and network. We are dealing with a different kettle of fish and therein lies why I suspect we find ourselves in a position where there were substantial cost overruns.

Q78 Mr Mitchell: They only had to pay the first £50 million of unexpected extra costs.

Mr Devereux: They had to pay all uneconomic costs.

Q79 Mr Mitchell: The first £50 million.

Mr Devereux: No, they had to pay the first £50 million economic cost above their bid. They had to pay all uneconomic cost above their bid.

Q80 Mr Mitchell: Subject to arbitration.

Mr Devereux: Yes. He was the man who would determine which side of the line it fell. It is not true to say that they were somehow limited to £50 million. No.

Q81 Mr Mitchell: Mr Bolt, you have no responsibility to maintain or defend the public interest in arbitration, you are just arbitrating.

Mr Bolt: I have statutory duties in the GLA Act to promote economy and efficiency. The restrictions come from only being able to exercise functions at the request of the parties and to do that on the basis of some of the specific provisions which are written into the contract. The periodic review reference I have had recently from London Underground in respect of Tube Lines—

Q82 Mr Mitchell: In that situation, if you find problems arising, to whom do you talk? Whom do you tell, Transport for London or the Department of Transport?

Mr Bolt: I publish all the guidance and directions that I am asked to give.

Q83 Mr Mitchell: You do not ring up the Department for Transport and say “Watch it. This is going to be a disaster”.

Mr Bolt: As Mr Devereux has highlighted, he and I had regular meetings since I was originally appointed at the end of 2003.

Q84 Mr Mitchell: Yes, but chat between chaps is no way of supervising a contract like this.

Mr Devereux: May I return to the lesson I have already adduced. This contract was set up on the basis that the Arbiter had certain information rights. I am proposing to you, and you are now agreeing with me, that the contract would have been better, for which my Department bears responsibility, had it been the case that when the Arbiter concluded something was amiss something could have happened to the taxpayer cash flow into the company. The contract did not provide for that. I am telling you today that a lesson learnt is that that is not a smart thing to do.

Q85 Mr Mitchell: Okay but you must have gone into the situation of this extraordinary lack of direct control with a good deal of faith in Metronet, its corporate governance, in TfL, in London Underground and their ability to manage it.

Mr Devereux: That is not an unreasonable statement. We went in with the proposition that £500 million of other people’s money would concentrate their minds.

Q86 Mr Mitchell: To make them virtuous and efficient.

Mr Devereux: That is what risk is about. They had equity.

Q87 Mr Mitchell: That is a wonderful faith.

Mr Devereux: I am trying to engage with you on what we must have been assuming at the time. If you actually say to somebody "If this goes belly up you are going to lose your £350 million or your £190 million of debt", you might have imagined that would of itself cause people to take action. The reality is that the action taken was insufficient.

Q88 Mr Mitchell: Why was the £1.7 billion overrun, loss, disaster not charged to local government in London? Why did you take it on your shoulders?

Mr Devereux: Because, as I am clearly failing to describe adequately, the nature of this transaction was that we repaid on the day the outstanding borrowing that Metronet had incurred. That borrowing would otherwise have been paid for by the public sector year after year after year, by London Underground backed by a grant from me. So in the grand scheme of things I have essentially prepaid what I would have paid anyway so that is not something which is obviously to be put on the shoulders of London Underground.

Q89 Mr Mitchell: When there was a discrepancy the problem was discovered in February and then you wait for the Arbiter's report until November. Surely this must have produced considerations as to who is going to be responsible for this funding. The question was: why is London not responsible for it? Let me put it another way. It must have come out of your budget as a department and that budget covers the rest of the country. Are we suffering with transport projects cut back and things which should be done in the north because of this overrun in London which you are forking out for?

Mr Devereux: The answer to the question in respect of the £1.7 billion that we paid is that was an additional grant which has been paid to the Department.

Q90 Mr Mitchell: So our budgets were not cut back.

Mr Devereux: Your budget has not been cut back. I do have slightly more to say about that, but it is at your discretion.

Q91 Chairman: Twice you have used the word "counterfactual" both in answer to me and to Mr Mitchell. You said that we need to compare the loss to the taxpayer to a counterfactual. Presumably by that you mean the cost overruns previously under London Transport and all the rest of it, that we have to compare what we lost here and what used to be lost in history. Is not the real comparator between the promises made to you that we are going to put an end to all these cost overruns and inefficiencies? That is the real comparator, is it not, not what happened in the dim and distant past and the failures of London Transport?

Mr Devereux: And that is the basis on which the C&AG has established the size of the loss.

Q92 Chairman: So this counterfactual argument that you have been referring to is meaningless.

Mr Devereux: No, it is not meaningless because several times your colleagues have sought to argue that actually there is something fundamentally wrong about these contracts which clearly everybody knew was going to produce this loss. I am simply observing that the delivered loss on these contracts is substantially less than has previously been the case. When you ask whether the Department have acted rationally in seeking to do this a different way, it seems to me I could plausibly answer "Yes, it was rational to go down this route" and even after the fact, even with the benefit of hindsight, that could still be true.

Chairman: A fair answer.

Q93 Mr Davidson: May I just clarify something in the documents we have here and whether or not you agree with Metronet's failure as being the way in which it had a weak central core basically and the five partners were more interested in carving up a share of the pie for themselves than contributing towards the general good?

Mr Devereux: I would agree with all of that and also add that I am profoundly disappointed that the banks did not do more by way of their lending rights.

Q94 Mr Davidson: I shall come to them in a minute.

Mr Devereux: I will agree with you. Lesson one: with these shareholders the company was not well run.

Q95 Mr Davidson: Was this not foreseeable? There are two elements here. One is an impression of a weak centre and the other is the barons, as it were, having a vested interest in pursuing their own interests rather than the interests of the company as a whole. Was that not foreseeable at the time?

Mr Devereux: As I tried to answer previously, that contractors might set up a purpose-built entity in which they themselves get work is not unusual. This is not something that came from planet Mars.

Q96 Mr Davidson: What I am trying to clarify in a sense is that you mentioned before a couple of road programmes with which you are familiar. What I am not clear about is whether or not the structure here is exactly the same structure that you have everywhere else and therefore whether or not the criticism which is applied here about weak management information, the barons being too powerful, applies in all these other contracts.

Mr Devereux: That is a fair question. I think the answer is that it does not, for two reasons. One fundamentally is that I do not go round the country guaranteeing other people's debts when I ask them to do a PFI deal. The M25 deal has very substantial amounts of private lending in it, not a penny of which has been guaranteed by me. When I said earlier on that I am only paying, I am only paying at the point at which five miles of motorway has been widened and another five miles is widened. I just do

not get into the game of worrying about the nature of their interaction because my exposure is simply different. In addition to that, notwithstanding the fact that I have in one sense very strong incentives to do it properly, we have, in the case of the M25, negotiated with the parties specific references to the way the company will be run and operated, including giving the Secretary of State rights in the event they do not run it the way they warranted to us in the first place. So we have learned from this sort of corporate failure.

Q97 Mr Davidson: That is helpful. So the practices you are applying now are as a result of the lessons of failure that you learned from this.

Mr Devereux: Yes, in that case. My primary defence on all these other contracts is that I am simply not paying for anything until I actually have it built.

Q98 Mr Davidson: I do understand that. I recognise that this is different. From what I am reading here, I would have thought that those who know more about these things than I do ought to have been able to foresee that some of these difficulties would have arisen. In particular, was the lack of management information being provided to the centre by Metronet and Metronet's inability to do anything and anything it did discover not foreseeable at the time?

Mr Devereux: If you mean at the time at which the contracts were let, the answer clearly, with the benefit of hindsight, is no. People assumed that—and I choose my words carefully—if shareholders actually owned the company to the tune of £350 million equity, they would have an interest in making sure that those perfectly normal flows would be part of it.

Q99 Mr Davidson: To be fair, that is a slightly different point. The idea that the shareholders would look after their interests and therefore things would work is not quite the same thing as saying that the centre of Metronet would actually have the powers to get the information. It seems to me, reading this, not being a London MP, not having followed every last blow in this battle, that in fact if there is a lack of power for the centre to get the management information to control the suppliers, it surely ought to have been visible at the time.

Mr Devereux: I agree with that, except that of course the person letting these contracts is Metronet. They are not somehow or other asking other people to do some stuff. The contract flows from Metronet, the corporate entity, down to the shareholders.

Q100 Mr Davidson: It comes back to the point some of my colleagues have made. You did not see those contracts then, is that right?

Mr Devereux: No, we did not see the contracts being made below Metronet; correct.

Q101 Mr Davidson: So you were not aware that it was a weak-centre, strong-barons model?

Mr Devereux: Our assumption was that this company had given us a plausible exposition of how it was going to deliver this through its tied sub-contractors and I think it must be the case, but I will check, that we were assuming, that being the case, they would put in place appropriate contracts. That is exactly what happened.

Q102 Mr Davidson: Sorry. Let me just be clear. It was your assumption. Many of these people, it can be assumed, would steal the silver if they were left alone to do so, that is the nature of business, is it not really?

Mr Devereux: A large part of the economy, if that is the way you think about it.

Q103 Mr Davidson: Indeed; I understand that. But you are there presumably to guard the spoons. Was it responsible of you just to assume that Metronet would set up a structure that allowed the centre to have control over the individual companies? Ought you not to have been exercising some sort of supervisory role? At no stage were these difficult issues identified by you.

Mr Devereux: You are stretching the limits of my knowledge.

Q104 Mr Davidson: That is what we are here for.

Mr Devereux: I know. The limitation is how helpful I can be in an afternoon. It was clearly known to the Department that the intended structure of Metronet was the way I have just described. I will go back and check that. We knew that there was going to be a tied sub-contracting arrangement underneath it. I do not believe that we had visibility of the precise information provisions in both sub-contracts.

Q105 Mr Davidson: Why not?

Mr Devereux: Why did we not? For the reasons I have given earlier which clearly, with the benefit of hindsight, are not satisfactory. We were assuming that companies which actually had some degree of money at stake would actually do this well.

Q106 Mr Davidson: You are assuming. Is that appropriate? You are putting public money at risk. Was it reasonable just to assume these things?

Mr Devereux: I cannot but agree with you that it is not sensible to leave it at that.

Q107 Mr Davidson: But you did.

Mr Devereux: What the Treasury has subsequently recommended, in giving guidance to writing contracts like this, is to make explicit provisions.

Q108 Mr Davidson: So the Treasury have sorted it now in a sense.

Mr Devereux: The contracts that we let were let entirely consistent with the guidance available from the Treasury at the time. In the light of this particular event and others, the Treasury guidance is now tighter as to what departments should be looking at under sub-contracting arrangements.

Q109 Mr Davidson: So it is the Treasury's fault.
Mr Devereux: No.

Q110 Mr Davidson: It is just a bad boy did it and ran away.
Mr Devereux: No, I am not going to say that.

Q111 Mr Davidson: In the nicest way you are saying basically that the Treasury has now changed. Surely you should have been doing that?
Mr Devereux: I was trying to do that in the spirit of understanding what lessons have been learned and what is different. What is different now is across Government.

Q112 Mr Davidson: Mr Bolt, following this exchange we have had, can you cast any light on this?

Mr Bolt: On the point that has been made so far about the expected approach of the shareholders, yes, you expect shareholders to make as much money out of a deal as they can and part of the reason for having the Arbiter is to make sure that if they exploit that position, so that if London Underground thinks it is being asked to pay too much, they can come to me for an extraordinary review or a periodic review. The surprise was that the company did not put in place the financial management systems, the risk management systems that you would expect to enable the shareholders to make a big return on this deal. When I looked at it in 2006, three years after they had entered into these contracts, I was still saying their financial management, their risk management, their asset management was poor.

Q113 Mr Davidson: Were you the only one who saw this?

Mr Bolt: Once I was asked the question, to produce the guidance on their performance, I had the information powers, including access to the sub-contracts and if necessary asking the sub-contractors for information. Those are statutory information powers.

Q114 Mr Davidson: Nobody else asked you for this.

Mr Bolt: No-one else had been asked to look at exactly that same question within that structure.

Mr Devereux: I think you will find that TfL was fairly well seized of the inability to deliver information that made any sense.

Q115 Mr Davidson: The final point I just want to pick up on is the question of the lenders. The whole thing about PPP was meant to be that bankers would keep their eye on things and be tough and control things and all the rest of it. Yet it did not happen here because they only had 5% of their money actually at risk. Was it not foreseeable that they would take their eye off the ball in these circumstances?

Mr Devereux: It depends whether you write down the figure 5%: surely that does not sound enough to get out of bed for? Or you write down £190 million.

Personally, for £190 million I would get out of bed. I do not think it is obviously foreseeable that just because it was 5% they would not take any action.

Q116 Mr Davidson: So do you disagree with the lines in the Report here which refer to the bankers, paragraph 2.23 "They did not have sufficiently strong incentives to do so" that is protect their investment "because only five per cent of their investment was at risk"?

Mr Devereux: I am going to argue that £190 million ought to be enough for a banker to get out of bed and protect the investment.

Q117 Mr Davidson: But it was not.

Mr Devereux: Clearly; by the fact that after the fact we know they have not protected it adequately, then that must be correct.

Q118 Mr Davidson: So they are a bad lot basically.

Mr Devereux: Those are your words. We know a lot more about banks now than we did previously.

Q119 Geraldine Smith: I have to admit my ignorance on this subject before coming to this meeting. I am not a London MP so I suppose I have not taken a great interest in this matter. One thing I have picked up on very quickly and am amazed you seem to have missed this point is that if someone only has 5% risk whilst the taxpayer has 95% risk that does not seem a very good deal to me. I think that would have raised alarm bells to start with, especially when you look at some of the companies. Thames Water, EDF Energy, Balfour Beatty, all companies who know exactly what they are doing, get together and say they want to be the shareholders for this new company but if they need to they can get out with very little risk.

Mr Devereux: When your Committee looked at this in 2004, you were perfectly clear that there were different ways of doing this. The Committee concluded bond financing would have been cheaper than the PPP financing costs though the risk of non-performance would then fall directly to the public sector. So the question which was trying to be assessed when these deals were being structured was whether a deal with a 95% guarantee in it was a better deal nonetheless than leaving it with London Underground to do. That is the test that my predecessor was seeking to work out, on a value for money basis, and the conclusion and all the evidence was that it was a better deal to do. You may argue that it would have been an even better deal if somebody had been prepared to do it with no guarantee at all, but that was not the question in front of us. The question in front of us was whether to put this money back into London Underground or to do it differently. A value for money assessment was made, and that choice was actually in favour of the PPPs. Simply to say now that "surely it was obvious that with 5% the whole thing could . . .", actually it was not obvious, no.

Q120 Geraldine Smith: May I ask Mr Collins how bad London Underground were if the preferable decision was to give the taxpayer a risk of 95%?

Mr Collins: Mr Devereux has previously attested to the problems that the London Underground had to deal with in some of the major upgrade problems on the Central Line and the Jubilee Line et cetera. It was that background against which the judgment was made.

Q121 Geraldine Smith: So they were pretty bad.

Mr Collins: Paragraph 1.6, the C&AG's words not mine, "There had been substantial cost overruns of over 30 per cent on the Jubilee line extension and the Central line upgrades. Neither project was completed on time or delivered the expected improvements in journey times".

Q122 Geraldine Smith: Yes, but the deal you ended up with was that the taxpayer paid £1.7 billion and it is okay you saying that they would have paid that over 30 years but it is very different paying £1.7 billion over 30 years and paying it right at the start or pretty early on. That is a massive difference to the taxpayer. The Report also points out that the spending was inefficient anyway so the money was not even spent efficiently.

Mr Devereux: I am not going to repeat what I said earlier. The £1.7 billion was indeed a prepayment if anything. That has not been scored.

Q123 Geraldine Smith: That was not good value for the taxpayer, was it?

Mr Devereux: I am sorry, the C&AG has simply not put that into any assessment to do with inefficiency because he has accepted that it is indeed technically the same value as paying it over the period. The interesting question is the things which were lost, which I do agree did exist; that is what gets to the £170 million and £410 million, but it is not the prepayment of the £1.7 billion.

Q124 Geraldine Smith: What ordinary people find hard to deal with, take for example a postal worker, is when they deliver a few letters into the wrong addresses and they do it a couple of times they get sacked. Someone somewhere must have some responsibility for what happened. I accept it is not you because you have come into the job since then but it seems very hard to get any accountability when something big goes wrong. I think that people do expect some sort of consequences when the taxpayer has to pick up the bill.

Mr Devereux: I understand the point you are making.

Q125 Geraldine Smith: What are you going to do about it?

Mr Devereux: For the moment, the C&AG has assessed that the principal accountability for this lies at the door of Metronet. They have lost £350 million. The executives at the time are no longer with the company, and I understand that there was no severance pay either. So if you want to know whether anybody is no longer in the appointment they used to be, the answer is the Metronet executives.

Q126 Geraldine Smith: To those companies involved £350 million is not a lot of money compared with what the taxpayer has picked up.

Mr Devereux: The only interesting question is whether it is worth a lot of money for those companies because actually those companies have had to write that off in their accounts; ergo it has an effect on their profits and their share price. Simply to dismiss it as being irrelevant because were involved in other numbers . . . The C&AG is assessing that the loss to the taxpayer is in the region of £170million to £410million. Against that, the £540 million which has not been paid to the private sector is a material number.

Q127 Geraldine Smith: Who actually drew up the original contract then? Was that London Underground?

Mr Collins: London Regional Transport led on drafting the original contract.

Mr Devereux: They are responsible to us, yes.

Q128 Geraldine Smith: Part of the difficulty as well is that there seem to be a lot of different fingers in this and it seems hard to get any real accountability.

Mr Devereux: Hang on a minute. I have already said that I can identify, having thought quite a lot about this as you would imagine, what would have had to have been different about this contract to prevent the loss which we are now seeing today. That would have been something to do with the information powers of the Arbiter and, critically, the ability then to adjust the payment going into the company. That was not done at the time because the assumption was, as has been attested, that with very large sums of private sector money at stake, that would concentrate minds.

Q129 Geraldine Smith: You told me earlier that when the decision was being made it was better for the taxpayer to have 95% of the risk rather than what London Underground would have done before, yet London Underground negotiated and managed the contracts.

Mr Devereux: No, that is to misunderstand what the nature of the contract was. The contracts to which the C&AG refers, that had a 30% overrun and were consistently late, were contracts, as it were, directly managed, as to defining what was happening, by London Underground. This was a different class of contract.

Q130 Geraldine Smith: What I am saying is that you appear to feel that London Underground were so incompetent that it would be better for the taxpayer to take a 95% risk with the private sector. Yet you seem to leave a lot of the running to London Underground, so why not just let them do it?

Mr Devereux: With great respect, that is not the position. I have not let London Underground run the contracts in the same way they were previously running them that produced the 30% overrun. I put in place a different contract which is actually an outcome specification which says "I want to have

these line upgrades with this extra capacity by these dates and you, private sector, go away and fix it and do it well and give me a price”.

Q131 Geraldine Smith: But they did not, did they? They made a complete mess of it and ended up in administration and the taxpayer ended up paying £1.7 billion ahead.

Mr Devereux: No. We keep going back to the £1.7 billion. I can keep disagreeing with you as to whether that is a metric for—

Q132 Geraldine Smith: Would you say this has been a success or a failure?

Mr Devereux: I would not say it was an unmitigated success obviously, because I have acknowledged that there is a loss.

Q133 Geraldine Smith: Would you say it was a failure?

Mr Devereux: I have said that £4,500 million has been economically and efficiently spent and in all history you have not had somebody come to this Committee and tell you that is the case.

Q134 Geraldine Smith: Success or failure?

Mr Devereux: I would regard it as a failure if you lose taxpayers' money.

Q135 Chairman: That is a big statement.

Mr Devereux: I am guessing that to say anything else would be foolish.

Q136 Geraldine Smith: You talk about the millions of pounds so flippantly. What some of that money could do in my constituency for improving public transport.

Mr Devereux: Believe me, I am not talking about it flippantly but I am making an observation that nobody at all is making any observation about the fact that £4,500 million of very precious money has been properly spent. I quite agree that £70 to £410 million has been a loss and that I regret; absolutely I regret. Do I regret that we embarked on a procurement that actually delivered a value to that extent, £4.5 billion? I do not regret it. I do not know that there was a better way of doing that. All evidence suggests that all previous ways would have failed.

Q137 Chairman: If I may say so, without wishing to sound pompous, I do not think the tone is helpful when a permanent secretary refers to half a billion quid. You are not some barrow boy in the East End of London. Could we not use the word “pound” please in future rather than “quid” when talking to the Committee of Public Accounts? There are some limits.

Mr Devereux: Okay.

Q138 Dr Pugh: Like Mr Hill, I just declare an interest. I was on the Transport Select Committee which looked at this before it became effective and we recommended you did not go ahead with this particular arrangement. Your defence of it now

appears to consist in the fact that although you have thrown an extra £1.7 billion at the project which was unanticipated, you might have ended up throwing more money if it had been done through a straightforward method of public procurement. Is that the case?

Mr Devereux: Yes.

Q139 Dr Pugh: At the time was it not the case that your Department—and in fact it was being widely quoted—did not say that; they actually said that this particular way of doing things would produce a saving of £4.5 billion. That was the original estimate of what the PPP would save, was it not? You were not actually suggesting that you would lose rather more money than the public sector: you were saying that were the public sector to do it and were the PPP to be done £4.5 billion would be the difference in the contractual price.

Mr Collins: I think that is a reference to the public sector comparator calculation which was done at the time over the full 30-year value of the contracts.

Q140 Dr Pugh: It was wrong, was it not?

Mr Devereux: In a sense this goes to the heart of the argument really. When these contracts were being let you quizzed my predecessor on the merits of either a) the contract as let or b) a public sector comparator, London Underground, doing it the way they have always done it. The facts in front of the Committee and the Accounting Officer at the time suggested that there was indeed a material gap between what we might expect from the PPP and what we might expect from London Underground. My contention this afternoon, notwithstanding the loss which I bitterly regret of £170 million to £410 million, is that this is a loss which is lower than would have been the case under the public sector comparator. I still regret the loss.

Q141 Dr Pugh: You are putting that forward as a hypothesis. I am not convinced that it is actually true. The Jubilee Line lost £1.4 million and you have already thrown £1.7 billion extra at the Metronet contract.

Mr Devereux: I am sorry, that is comparing apples with pears.

Q142 Dr Pugh: You are.

Mr Devereux: No, I am sorry; no, I am not. That was a calculation of what extra had been spent. You are comparing prepayment of a debt, which is something I would have paid anyway. The C&AG, with respect, has made his assessment of what the actual loss was and his assessment was that it was £170 million to £410 million. Manifestly that has nothing to do with the size of the £1.7 billion. There are elements within that which he scored. We keep coming back to whether £1.7 billion is the answer. With the greatest respect, it is not the answer to the question of what was lost. The answer to that is what the C&AG has scored.

Q143 Dr Pugh: However we interpret it, it was not sold on the basis that you only had to spend £1.7 billion extra and additional to contractual price. It was sold largely on the basis that it would perform at the contractual price. I think you did say that the private sector has lost £500 million on this job.

Mr Devereux: I said that was the value of the equity and the uncovered lending.

Q144 Dr Pugh: There are five companies in the consortium. Are you able to tell us exactly how much they have lost in the process?

Mr Devereux: They have extinguished their equity in Metronet which adds to £350 million and there is a table at the back of the Report in an appendix.

Mr Collins: Page 41, Appendix 3 is the C&AG's calculation of losses.

Q145 Dr Pugh: It is the breakdown of individual company's losses.

Mr Collins: Yes.

Mr Devereux: It is Figure 21 on page 41.

Q146 Dr Pugh: Given that we are having this debate, do you not think—and maybe I am asking you to make a political comment here; I hope I am not—it would have been helpful at the time this contract was let if the Treasury had been more ready to appear before the relevant committees and explain the basis of their cost assessment process? They had to be dragged kicking and screaming and in the end said very little. I remember very specifically the session in which that happened.

Mr Devereux: I am afraid that is a question you will have to ask the Treasury. All I can say is that the Department itself was responsible for doing these deals. It was my predecessor accounting officer who had to sign off that they were value for money and he did so.

Q147 Dr Pugh: Will you accept the fact that what we are trying to do is find an element of public accountability here? At the time the decision was made the view of the Transport Select Committee was that they needed to talk to the Treasury about the cost of this and the Treasury refused. Is that not the case?

Mr Devereux: I do not know.

Q148 Dr Pugh: It is true. Can you tell me why precisely you think, in your personal judgment, Metronet got their figures so badly wrong in terms of the added cost of the project?

Mr Devereux: It is almost as straightforward as the following. The company in question, which was in receipt of the money from London Underground, simply had insufficient visibility and control over where it was subsequently spending that money down the supply chain. Having received X pounds, which they were entitled to, through the infrastructure service charge and drawn down Y pounds of debt, they had insufficient control over what their sub-contractors were then doing with the

money. They were at no stage able to say “That’s good. I’ve spent Y pounds and I’ve got Y pounds of value. I’m clearly on the case”.

Q149 Dr Pugh: It was not the case that they met additional problems they had not anticipated when tendering for the work or that the sub-contractors did.

Mr Devereux: Primarily the reason they got into difficulty was because they did not know what they were doing. It is equally true though, as is referenced by the fact that the Arbiter at the end of the day concluded that there were grounds for additional funding of the company because of additional economic and efficient spend, that other things had been done. Those extra things which were done and done efficiently fall into two categories. They are either things which London Underground has managed to add to the specification, in other words they have asked for more to be done. Or, alternatively, it turned out to be more expensive to do some of this work than any party had imagined. It was in the nature of work in the Underground, as has been attested by London Underground as well as the “infracos”, that it is an uncertain environment. When you take back 150-year-old tiles it is not immediately clear what is behind it. My perception is that three things went wrong. One was that they had insufficient control but yes, there were some additional costs going on there as well, some of which were London Underground's responsibility, some of which reflected the fact that there were more for people to do than anyone knew and that was the nature of the deal.

Q150 Dr Pugh: MPs do not always get everything right but I think the Transport Select Committee's comments here are worth reading. They said “We are concerned that the register of assets against which the future costs of the improvements to the Underground have been estimated is insufficiently developed and incomplete. The establishment and maintenance of a complete register of all assets is a priority for the Underground network and should have preceded the PPP contract negotiations”. That is what we said back in 2002. Your Department presumably knew that as well.

Mr Devereux: Yes. The PPP contracts as let require—I think I have this right—that all the “infracos” produced precisely that level of information by the end of the first period, but it was deemed impossible to get to that level of contracting without that amount of work. In a sense the Select Committee's recommendation would effectively have meant that no work was being done over the seven years because it would have taken a long time to get to that position. We are talking about loads of tunnels. Can you imagine how much?

Q151 Dr Pugh: So you were starting knowing that there was significant risk of overspend because you do not basically know what you are doing really in terms of engineering problems.

Mr Devereux: It was consistently the understanding of this contract that one of its problems was the unknown state of the assets. Remember the reason why the incoming Labour Government wanted to make something of this was because for 30 years over successive governments people had not been putting money into the Tube. Unsurprisingly therefore there was not, on arrival in 1997, an asset register.

Q152 Dr Pugh: Yes, but you do not need to be very bright to realise that if you do not have an adequate asset register and you are doing some very complex engineering works, there is a very significant possibility of cost overruns which is actually what you met.

Mr Devereux: Except that the contracts have not provided that significant cost overruns in the sense of laziness and incompetence should come back to the taxpayer. The contracts provided that significant cost overruns which were done economically and efficiently could come back to the taxpayer. So the way in which the Government of the day decided to tackle this was to say "I want to get on with this work. I don't know what is in there. I am prepared to pay people if they upgrade economically and efficiently. I will establish by statute an arbiter to judge that. I will not pay if they operate inefficiently but let us get on with the work".

Q153 Dr Pugh: We actually said that we remained unconvinced that the Arbiter would have sufficient powers to prevent the incumbent infrastructure companies pressing for more favourable terms at seven-and-a-half-year reviews. Which is more or less what happened.

Mr Devereux: We have not got to that yet.

Q154 Dr Pugh: One last fairly obvious thing. The governance arrangements are criticised by the NAO saying that it is a very complex arrangement and the decision making is rather poor. When you have a consortium of five different companies did you not expect that? I refer to page 6 where it says "The main cause of Metronet's failure was its poor corporate governance and leadership". You could see the structure of the governance and leadership from square one. Did you not think that was a problem then?

Mr Devereux: No.

Q155 Chairman: Since the Treasury has been mentioned by Dr Pugh, perhaps we could bring in the Treasury. In the light of what has gone on here, are you going to bring in new controls to these kinds of devolved arrangements in future?

Ms Diggle: That is a very good question. We certainly need to think quite a lot about what has happened here. There are some very disturbing messages. What troubles me is that in a part of devolved government there is a limit to what we can do. However, I cannot help sympathising enormously with what a number of Members have said that good management information systems must be the key to this. It is a comment this

Committee frequently makes and I frequently repeat on your behalf. I need to think about that very carefully and see what can be done.

Q156 Mr Bacon: It is not often I feel a lot of sympathy for the Department of Transport but in this case I do to some extent and it is certainly clear from the Report that the private sector lost £540 million. I suppose you might have thought that was a reasonable risk for them to take. I think it would have been a lot worse if you were sitting here having to justify a loss not between £170 and £410 million but £900 million because you had taken all of that on the chin. So the risk was spread to some extent. I still have some serious concerns about this. The first one really is about the role of the Arbiter. Mr Bolt, it is clear, is it not, that you could really only act if you were asked to act by the parties? Is that a correct summary?

Mr Bolt: I have two functions under the Act: giving guidance, giving directions and both of those functions are exercised on the request of the parties. I do have further powers which include consultation and—the wonderful words of parliamentary draftsmen—doing all such things as I consider necessary or expedient, but in preparation for a reference. It was made very clear to me in 2005 that neither of the parties wanted the Annual Report reference. In that situation I did not have powers to do anything.

Q157 Mr Bacon: No, that is exactly what I thought. Mr Devereux, if the Arbiter was not asked by the parties to act, how could you, as the Accounting Officer come anywhere near an estimate of the public sector liabilities?

Mr Devereux: At the time, with difficulty.

Q158 Mr Bacon: Given that you knew that you were going to be paying, you said repeatedly, and it was actually said by your predecessor in 2004, that the GLA Act made the position difficult for you and that you could not interfere constantly. Given that you knew you were going to be paying the majority of this with your £1 billion, how much hindsight would it have required to have given the Arbiter greater powers? I looked up the old Report, the one we took evidence on in 2004, which I am sure you are familiar with and there is this enormous chart here which showed what the professional advice was at the time. Freshfields, the lawyers, were paid £29 million, PricewaterhouseCoopers were paid £21 million, PA Consulting was paid £12 million, Arthur Andersen business advisers were paid £38 million and so on. In fact that is not the total of it; it was tens of millions of pounds on professional advice to structure this and yet despite all that very expensive advice you ended up with a situation where Mr Bolt, or his predecessor, could not act. Have you asked for your money back from Freshfields?

Mr Devereux: No, I have not.

Q159 Mr Bacon: How do you spend that much money on professional advice and end up with something which gives you such inadequate powers?

Mr Devereux: I have been perfectly frank with the Committee all afternoon. It was because the model that was clearly in view at the point at which these judgments were being made was that with equity and debt at risk, were something to go wrong with this company, those people with money at stake would right it. There was not written into this contract, what manifestly we needed with the benefit of hindsight, the shipwreck clause which said “Suppose that, just hypothetically” —

Q160 Mr Bacon: Surely that is why you pay a lawyer £29 million for every conceivable circumstance, is it not?

Mr Devereux: You might hope so.

Q161 Mr Bacon: Yes, I would have thought so. The other thing is that I can understand why you might have thought that Balfour Beatty and W S Atkins and all these folk who have £500 million in the pot might have taken a bit more notice how the thing was being managed and risk managed and so on.

Mr Devereux: Yes.

Q162 Mr Bacon: I also might have understood why the banks did not take that much notice because they knew perfectly well, based on the guarantee and on your comfort letter, that they were pretty much covered. However, just as the equity holders were in for a big piece and therefore you might have expected that they would take a serious interest in it, you, on behalf of the taxpayers knew you were in for a big piece because you had to be. You were paying this £1 billion a year grant and that was being used to pay the annual unitary charge ultimately by London Underground. So you too knew that you were in for a big piece. What comes through again and again in this is that the Department for Transport was taking quite a hands-off approach. Should you not have assumed, just like you did for the equity holders that being in for that much money would have caused you as the Department for Transport to take a tighter, closer grip just in the same way as you were expecting the equity holders to do?

Mr Devereux: I understand the question. I just disagree with the answer which is simply this. The way I would have prevented this loss occurring would have been to structure the contract between LUL and the “infracos” differently. I do not believe actually it would have helped matters to have structured the contract to put three players in play with some sort of walk-on rights for the Department in certain circumstances to do somewhat unspecified things. The thing I could have done with the contract, even keeping it simply between two parties, LUL and the “infraco”, would have been to have changed the nature of the Arbitrator’s role and in particular, when he found there was either no information or the information led him to conclude that there was no risk of them burning their equity and their debt—

Q163 Mr Bacon: That he would have been able to do something about it.

Mr Devereux: That he would have given LUL—LUL not me—the right not to pay the infrastructure service charge. That would have self-regulated that arrangement and I regret that it was not in the original contract.

Q164 Mr Bacon: You referred earlier to dialling down the price. Do you think though that if that had been included at the time, if I had been a private sector participant I would have said “If you want that ability to dial down the price then I am going to make the price higher to start with”? Would that not have been the obvious corollary of that?

Mr Devereux: It might have been. Let us just think about it. What we are just saying is that the only circumstances in which we would be dialling down the price would be the circumstances in which the Arbitrator had reason to believe—and it would have to be a reason to believe because he would not have finished a review—that the uneconomic cost, the inefficient cost to this company was getting close to £540 million. It seems to me that for a company then to turn round and say “Who knows? Maybe I will get close to £540 million. I will charge you more for the privilege” . . . They might have done but you might have hoped that in the process of getting a competed contract structured on that basis they might have thought “That is a reasonable way of doing it. I know I have equity at risk. If that actually goes through, why would the public sector come and bail me out?”.

Q165 Mr Bacon: You have painted a reasonably plausible explanation of why the Department for Transport was slightly distanced from it all. I am not sure I completely buy it but I see where you are going with it. You also said that Metronet did not have much control over what it got its contractors to do. It is also the case that London Underground did not. It says in paragraph 12i, page 7 of the main Report “London Underground did not have sufficiently detailed information to take a ‘partnering approach’ with confidence and did not have the full array of contractual levers”. We understand that the Department for Transport did not have all the levers but London Underground, according to the Report, did not have the full array of contractual levers to drive improved performance where necessary. It seems that nowhere in the system was there anyone designed through all this expensive legal advice, to have enough contractual grip. Was there?

Mr Devereux: The bit about London Underground’s views are, I have to say, somewhat contested by different parties.

Q166 Mr Bacon: Which brings me on to my next question.

Mr Devereux: You will recall the Mayor’s attitude to the PPPs. Just in case I needed it I brought with me Tim O’Toole’s own observation about information powers when he was in front of your Transport Select Committee.

Q167 Mr Bacon: Which question number because I have it in front of me as well?

Mr Devereux: It is question 240, “Mrs Ellman: Mr O’Toole, you said that a major problem was lack of information”. Mr O’Toole said that there should have been more transparency, more accurate information. “I think there has been a concern on the part of all the infracos that more information to LU would mean that LU would meddle more, would want to take more control, and I think further if you consider the political climate when we took over, with the things that the Mayor has said and what Bob Kiley . . . had said, there was a real concern that information would be used in ways other than to manage the contract for the purposes of maybe rhetorical argument”. So when London Underground tells you that they do not have all the information which they would like, bear in mind that Tim is acknowledging that people’s perceptions of quite what information they were after, and for what purpose it would be used, were being argued over. I am not saying that is a defence for no information, but these contracts were set up essentially as outcome specifications and the proposition was “That is what I expect you to do. I will pay you month in month out if the availability of trains is at this level, if the ambience of the stations is at this level, if the service is at this level. I am paying you for delivery”. That is what the contract said. It does not require obviously a very detailed grip. Tim’s background is managing contracts with every single jot and tittle of things written down at the start. It is a perfectly good way of running contracts. It is not obviously one which drives out innovation like changing escalators from six months to six weeks. We were paying for a contract that actually provided some space for the private sector to do something better and differently, and, in some regards, I am going to argue that is what you got as well.

Q168 Mr Bacon: Do you and the Department discuss with the NAO who comes as witnesses to these hearings?

Mr Devereux: I ask to bring some people and sometimes you invite people.

Q169 Mr Bacon: You did not ask to bring the current managing director of London Underground.

Mr Devereux: No.

Q170 Mr Bacon: It is just that in 2004 Tim O’Toole came.

Mr Devereux: I think you might have asked him.

Q171 Mr Bacon: He is described on the web—this is Mr Richard Parry who is the current managing director of London Underground—as being responsible for leading the largest transformation programme the Tube has seen in generations. I should have thought he would have been a quite useful witness for us to have had. I just wondered whether you had any discussions with the NAO which had led to him not being a witness today.

Mr Devereux: As I understand it, you are allowed to invite whomever you wish.

Q172 Mr Bacon: Ultimately we do invite whom we wish but you could rely on the advice of the NAO. I know from previous hearings that is often on the basis of discussion with the department and I am just wondering what discussions took place, if any, on those occasions.

Mr Devereux: I made clear that I expected to bring with me Paul and Chris. I have not gone out of my way to get LUL to come.

Q173 Mr Bacon: May I just ask why you did not get LUL to come? Given that description I have just given would he not have been an obvious person?

Mr Devereux: Having read the Chairman’s press notice and expected the questions to be about the role of the Department, I thought you would expect to see the Department.

Mr Humpherson: We advised the Committee to invite the Department because the Report is about risk management undertaken by the Department and managing the taxpayers’ exposure to unexpected costs and to loss. We had no discussions with the Department about whom they might invite as accompanying witnesses.

Q174 Mr Bacon: Why did we have Tim O’Toole in 2004?

Mr Humpherson: I think probably in the 2004 Report we were talking about the prospect of making the contracts a success and in those circumstances having all of the contracting parties available to answer questions seemed sensible. This Report is about the taxpayers’ exposure to loss.

Mr Bacon: It still talks about London Underground. It still talks about the fact that they did not have the full contractual levers available, so I think it would have been useful to have them.

Q175 Mr Mitchell: Looking at Metronet and trying to place it in the catalogue of great British disasters, there was another contract with Tube Lines. Why was that comparatively okay whereas this was such a mess? Was it that Metronet took on more difficult lines and stations? Was it a different contract? Was it the corporate governance of Metronet which looks to be a coalition of suppliers out to make a bob or two by supplying the work and they dominated the corporate governance? Which of those explanations explains the failure of Metronet and the comparative success of Tube Lines?

Mr Devereux: Personally I would put it largely down to the culture which has been created in Tube Lines which is “This is the contract. We’re going to deliver it at the price we bid for” and actually that is what we have had. That is what shines through the evidence given to the Transport Select Committee when you have had the chief executive in front of you. They have indeed majored—and this is the nature of their shareholders, by having the involvement of Bechtel and the like—on very good programme and project management. Tim O’Toole speaks very highly of the very, very strong grip which Tube Lines has over its contractors. They have put all of their work out to tender.

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Q176 Mr Mitchell: They have the same guarantees, do they?

Mr Devereux: They have the same guarantees. They put all their work out to competitive tender and when they had problems with sub-contractors they brought the sub-contractors back in-house. They have gone at this subject in a way which, I am going to assert, we assumed that somebody with that much money at stake would actually do. To date they have done very well. They still have to deliver the Jubilee Line upgrade so I am not going to make promises about things which we have not finished yet. They have clearly made a much better fist of this than Metronet.

Q177 Chairman: That concludes our hearing. We are not going to quibble about sums but at the end of the day the taxpayer has lost up to £410 million. Acceptance is a first step towards change; that is what our wives tell us anyway. We hope that the DfT will now improve in the future, although you have not really been prepared to admit through this hearing that there has been a failure in the past.

Perhaps you have given us a grudging apology but I was struck by one strange thing you said to Mr Bacon just now. You said that you could not foresee a shipwreck. I would have thought it was very possible that these kinds of projects might end in shipwreck. That is why you have all this extremely expensive advice to the tune of £130 million. Anyway I am going to give you the last word. You can give an apology if you wish, because acceptance is the first step towards change.

Mr Devereux: I thought what I said to Mr Bacon was that we did not expect a shipwreck and did not provide for it. I am saying, with the benefit of hindsight, since you want to have lessons learned, that clearly a reliance on private sector money being at risk is insufficient. You may argue that we knew that all along. It clearly was not part of the conversation that we had back in 2004. It was not included in the contract. That was a mistake. Had that been included we would not be discussing this loss today.

Chairman: Thank you very much and thank you to your colleagues.

Supplementary memoranda from Permanent Secretary, Department for Transport

NEW ARRANGEMENTS TO MONITOR PROGRESS ON FORMER METRONET CONTRACTS

At the PAC hearing on 19 October I noted that I was expecting my Secretary of State and the Mayor of London to make an announcement shortly on new arrangements for managing the former Metronet contracts.

I am pleased to enclose copies of my Secretary of State's written statement and joint DfT/TfL press notice¹ issued last Thursday announcing permanent contracting arrangements for the ex-Metronet contracts and new independent scrutiny arrangements for the whole TfL investment programme.

The Government has taken a pragmatic view about the contracts which Metronet had already let, agreeing with the Mayor and TfL that these should now be managed by London Underground. A decision on the best contractual form for the Bakerloo line upgrade, yet to start, will be made at a later date.

Direct management will require London Underground to build its own capability, and a restructuring has already taken place. Given the importance of this work, and the large sums of money involved, the Secretary of State has also agreed with the Mayor a new independent advisory panel, with a remit to advise both on the progress of individual projects, and on the overall efficiency and effectiveness of the way the TfL programme is managed and delivered: this body's reports will be available both to the TfL Board and to the Secretary of State; membership of the panel will be decided by the Mayor, from a shortlist agreed with the Secretary of State.

6 November 2009

Written Ministerial Statement for 29 October 2009

TRANSPORT FOR LONDON: NEW CONTRACTING AND SCRUTINY ARRANGEMENTS

The ex-Metronet investment programme covers the upgrade, maintenance and renewal of infrastructure on the Bakerloo, Central, Victoria, Waterloo & City and the Sub-Surface (Metropolitan, Circle, District, Hammersmith & City) lines. It will deliver nearly 30% more capacity across the network, improving journey times and reliability.

Following the administration of Metronet in July 2007, its assets and obligations were transferred to Transport for London in May 2008 as an interim measure. The former Mayor and Secretary of State for Transport tasked a Joint Steering Committee consisting of Transport for London (TfL) including London Underground Limited (LUL), the Department for Transport and HM Treasury with considering a range of

¹ <http://nds.coi.gov.uk/content/detail.aspx?NewsAreaID=28ReleaseID=408038&SubjectId=2>

options for the permanent structure of the Metronet contracts, with the objective of providing a stable and safe operational framework and delivering the modernisation, upgrade and maintenance of the tube infrastructure at an affordable price that offered Value for Money for the taxpayer.

The Mayor and I have accepted the Committee's recommendations that the contracts inherited from Metronet should remain under the direct management of LUL as the best value option under the present circumstances, with the majority of upgrades already underway. Some of these contracts have since been renegotiated to secure more favourable terms for LUL. Future contracts will be procured directly by LUL, including robust performance incentives and transferring risk where appropriate. LUL will remain responsible for all asset management decisions, but there will continue to be substantial private sector involvement through the contracts managed by LUL. A decision on the most appropriate contracting arrangement for the Bakerloo line upgrade (which has not yet started) will be taken nearer the time, reflecting lessons learnt from the earlier upgrades.

LUL is investing in its management and organisational capacity and capability in order to meet this new challenge. Organisational restructuring within LUL has also created a clearer separation of client and delivery functions, with a defined sponsor for each project.

Underpinning these new arrangements and responding to the increased size of TfL's investment programme are new scrutiny measures at Transport for London. The Mayor will establish an independent advisory panel with remit extending across the entirety of the TfL investment programme, including all maintenance, renewal, upgrades and major projects across the modes, but not operations.

Members of the new panel will be appointed by the Mayor from a shortlist agreed with me. The Mayor and I will also agree the panel's terms of reference. The panel will report to the TfL Board and the Mayor as its chair. The members of the panel will have experience in a range of disciplines including engineering, finance and project management, ensuring that as a whole the panel will be able to offer expert advice, opinion and challenge on all aspects of TfL's investment programme, including the ex-Metronet works.

The panel will be able to review all aspects of project delivery including cost and programme deliverability. It will also review delivery of the investment programme at a portfolio level, including management and organisational capability and the efficiency, effectiveness and economy of delivery of the investment programme. The panel will report its findings directly to the TfL Board, who will also receive a TfL management response setting out how the issues raised have been or will be dealt with. The panel will commission other reports as it or the TfL Board consider appropriate. It will publish an annual report making overall conclusions on the delivery of the Investment Programme. Copies of all reports will be provided to me, in view of Government's significant contribution to the investment programme through the GLA transport grant which accounts for just under 40% of TfL's total income.

These new arrangements build on the work of LUL during the interim period and will offer the stability and certainty LUL need to deliver the investment programme inherited from Metronet and with it the improvements so critical to growth and prosperity in London.

These arrangements are in accordance with the existing framework of devolution of powers to the Mayor, who now bears full responsibility for delivery of the upgrade, maintenance and renewal work previously the responsibility of Metronet.

Tube Lines will remain responsible for the upgrade, maintenance and renewal of infrastructure on the Jubilee, Northern and Piccadilly lines under its PPP, with independent scrutiny provided by the PPP Arbiter.

Further supplementary memorandum from the Permanent Secretary, Department for Transport

In the course of giving evidence on the NAO's report *The Failure of Metronet*, I was asked whether "anybody had been sacked as a result of this debacle" (Q 36).

Later in the session (Q 125), I told the Committee that "the executives at the time are no longer with the company". I was referring here to the evidence at Q 291 to the Transport Select Committee on 7 November 2007, where the Administrator was asked about compensation for Metronet Directors. He explained, "we have made no payments for loss of office to any of the five parties. . . . we offered them a certain amount of, if you like, retention, loyalty payment, which only worked for as long as they stayed with the company and we wanted them to stay with the company, but we have not paid them anything at all for breach of contract, as is normal in these cases, and their claims will rank in the estate."

As I also explained, on several occasions (Qq 2, 13, 45), while I regretted the loss which occurred, it is my strong contention that the actions of my Department have resulted in a better outcome for the taxpayer than would have been the case under previous arrangements.

It is also the case, quite separately, that the Department has a duty of care to its employees, under employment and data protection legislation, and that any disciplinary and employment issues would remain a matter of confidence and trust between the Department and its employees.

16 November 2009